## SUMMARY

### Analysis of the 2004-2005 Mayor's Proposed Budget

This report provides an overview of the 2004-2005 Mayor's Proposed Budget of $3.735 billion, and makes comparisons to the 2003-2004 Budget, which totaled $3.105 billion. The report also includes our analyses and comments related to revenues, appropriations, and other budgetary aspects of City operations included in the 2004-2005 Mayor's Proposed Budget.

**Overview**

The estimated revenues included in the 2004-2005 Mayor's Proposed Budget consist of Local sources, State sources, and Federal sources in the following amounts and percentages, as compared to the 2003-2004 Budget:

| | 2004-2005 Estimated Revenues (In Millions) | Percent of Total | 2003-2004 Estimated Revenues (In Millions) | Percent of Total |
|---|---|---|---|---|
| Local sources | $3,067.9 | 82.2% | $2,285.4 | 73.6% |
| State sources | 445.9 | 11.9% | 509.0 | 16.4% |
| Federal sources | 220.8 | 05.9% | 310.9 | 10.0% |
| Total | $3,734.6 | 100.0% | $3,105.3 | 100.0% |

The 2004-2005 Mayor's Proposed Budget includes a new Department of Administrative Hearings, the purpose of which is to streamline code enforcement within the City related to quality of life issues such as zoning violations, property maintenance, and illegal dumping. In addition, a new Office of Homeland Security, focusing on the City's preparedness and streamlining the process of obtaining vital grants and homeland security funding from state and federal sources, is included in the Budget. The Budget does not include the Consumer Affairs Department, since its functions were transferred to other City agencies. This Department was included in the 2003-2004 Budget, with $1.6 million of budgeted appropriations. Also, the Detroit Housing Commission (DHC) has been removed from this Budget. The DHC was included in the 2003-2004 Budget, with $86.2 million of budgeted appropriations.

The 2004-2005 Mayor's Proposed Budget of $3.735 billion is approximately $629 million, or 20.3%, more than the 2003-2004 Budget of $3.105 billion. However, if the $675 million revenue related to the sale of Water and Sewerage Revenue Bonds in the 2004-2005 budget is factored out of the analysis, the 2004-2005 Mayor's Proposed Budget provides for a decrease of $46 million (1.4%), as compared to the 2003-2004 budget.

8. Municipal Service Fee
   The 2004-2005 Mayor's Proposed Budget includes $17.1 million in budgeted appropriations for 125 police officers and 48 fire and emergency medical service (EMS) employees for public safety services for the three casinos. These appropriations are offset by budgeted municipal service fees of $14.3 million to be collected from casino operators and $2.8 million from the General Fund.

**Conclusion**

In our opinion, the 2004-2005 Mayor's Proposed Budget contains several revenues that are too optimistic and pension appropriations that are understated. We identified the following:

- State Revenue Sharing revenues of $287.7 million are unlikely as the State may make further cuts.
- Delinquent tax collections of $79.6 million are optimistic based on the performance of the outside collection agency.
- DDOT farebox revenues of $29.1 million are optimistic.
- Pension appropriations of $224.1 million are understated by $21.9 million mainly because the PFRS actuary contribution rates were not used.

We caution against the use of long-term debt to fund current expenditures. This practice is contrary to the City's Debt Management Plan and prudent fiscal management.

## Major Component of the Increase in Revenues

| | Increase/(Decrease) In Millions |
|---|---|
| Sale of Water and Sewerage Revenue Bonds | $ 675 |
| Pension Obligation Bonds | 80 |
| Sale of Assets | 36 |
| Delinquent Taxes | 29 |
| Other Local Sources – Net | 23 |
| Municipal Income Tax | 11 |
| Other Federal Sources – Net | 8 |
| Supplemental Fee (GDRRA) | 8 |
| Wagering Tax (Casinos) | 6 |
| Library Revenues | 6 |
| Property Tax | 4 |
| Health Grant | 4 |
| Mass Transportation Funds | 4 |
| Internal Reserve Fund | (4) |
| Public Health Program | (7) |
| Subsidy from General Fund | (8) |
| Michigan Occupational Skills Training Grant | (10) |
| Home Investment Grant | (11) |
| Sales and Charges for Services | (15) |
| Licenses, Permits and Inspection Charges | (22) |
| State Revenue Sharing – General Fund | (25) |
| Housing Comprehensive Grant | (28) |
| Other State Sources - Net | (35) |
| Casinos Enhancement Revenues | (47) |
| Federal Housing Subsidy | (53) |
| **Net Increase in Revenues** | $ 629 |

## Major Components of the Increase in Appropriations

| | Increase/(Decrease) In Millions |
|---|---|
| Salaries and Wages (decreases resulting principally from elimination of 997 positions due to layoffs, vacancies, and DHC separation) | $ (12) |
| Employee Benefits (primarily related to increases in hospitalization and pension costs) | 80 |
| Professional and Contractual Services (decreases related to various Departments, particularly City Council, Department of Public Works, Non-Departmental - DRMS project, Recreation, and Water and Sewerage Departments) | (21) |
| Operating Supplies (Sewerage Department chemicals account and other City departments) | (8) |
| Operating Services (agreement to pay supplemental tipping fees to the Greater Detroit Resource Recovery Authority) | 8 |
| Capital Equipment and Outlays (increases related to Airport, Detroit Institute of Arts, Museum of African American History, Cultural Affairs, Fire, Historical, Public Lighting, Health, Public Works, Planning and Development, Police, Recreation, Zoo, and block grant allocation) | 4 |
| Fixed Charges (e.g., increase for debt retirement of principal payments primarily in the Water and Sewerage Departments, offset by decreases for interest on bonded debt, reduction of People Mover and Building and Safety Engineering subsidies) | 72 |
| Other Expenses (major portion of increase primarily due to $675 million Water and Sewerage Revenue Bonds offset by reductions for DHC separation, training, and other initiatives) | 506 |
| **Net Increase in Appropriations** | $ 629 |

In general, our analysis focused on budget items with General Fund impact. The General Fund appropriations included in the 2004-2005 Mayor's Proposed Budget total $1.582 billion, or 42.4%, of the City's total 2004-2005 appropriations, and $84.0 million, or 5.6%, more than the 2003-2004 Budget amount of $1.498 billion.

**Revenues:**
The five largest components of recurring General Fund revenue, in descending order by budgeted amount, are municipal income taxes, state revenue sharing, property taxes, wagering excise taxes (casinos), and utility users excise taxes. In addition, the 2004-2005 Mayor's Proposed Budget anticipates substantial revenues from the sale of bonds.

Municipal income tax revenue is estimated at $311.0 million in the 2004-2005 Mayor's Proposed Budget, or $10.6 million (3.5%) more than the 2003-2004 budget amount of $300.4 million. For the fiscal year 2004-2005, the income of residents and nonresidents will be taxed at the rate of 2.5%, and 1.25% respectively while the corporate tax rate will be 1.2%. The tax rates are the same as the prior year due to suspension of Public Act 500 of 1998. The municipal income tax revenue for 2002-2003 (the most recently completed fiscal year) was less than budget estimates by $12.6 million (3.9%). The $301.9 million projection for actual municipal income tax revenue for 2003-2004 is $1.5 million more (0.5%) than the budget amount of $300.4 million. Based on our analysis of the estimated collections for 2003-2004, the stable income tax rate, and the growth rate forecasted by local economists, the projected income tax revenue amount of $311.0 million for fiscal year 2004-2005 appears reasonable.

State revenue sharing, budgeted at $287.7 million, was the most stable of the major General Fund revenues. In January 1999, Public Act 532 of 1998 froze the City's revenue sharing payments at $333.9 million, for the period from the State's 1998-1999 fiscal year to the State's 2005-2006 fiscal year, and an annualized amount of state revenue sharing for the nine-month period ending June 30, 2007. However, in order to maintain a balanced State budget, the previous and current Governors slashed state revenue sharing payments across the board for the State's 2002-2003 and 2003-2004 fiscal years. Detroit's share of the revenue sharing reductions over the two-year period and the budgeted decrease included in the Governor's Executive Budget for next year total $46.2 million. The 2003-2004 budget of $312.5 million has not been adjusted for the $22.8 million reduction made by the State legislature in December 2003. State revenue sharing revenues contained in the Mayor's 2004-2005 Proposed Budget are $24.8 million less than the amount budgeted for 2003-2004, and agree with the payments budgeted to Detroit in the Governor's 2004-2005 Executive Budget. However, this amount is unlikely to be received. An economist at the State of Michigan House Fiscal Agency believes that there is the possibility of additional cuts in revenue sharing, as high as 20%, which would reduce the City's revenue sharing payment to $230.2 million.

The 2004-2005 Mayor's Proposed Budget includes $216.6 million for net property tax revenue. As noted in our analysis, this amount contains $3.7 million of taxes on non-ad valorem properties that should be included in Other Revenues. The $216.6 million budgeted for fiscal year 2004-2005 is an increase of $4.1 million (or 1.9%) from the 2003-2004 Budget. The 2004-2005 budget for net property tax revenue appears reasonable.

The 2004-2005 Mayor's Proposed Budget includes revenues of $79.6 million for the collection of delinquent taxes, an increase of $28.8 million over the $50.8 million budgeted for fiscal year 2003-2004. Assumptions underlying the fiscal year 2004-2005 budgeted collections are: increased revenues on delinquent taxes from Wayne County under Public Act 246 of 2003, the full year impact of the outside collection agency efforts in collecting older delinquent taxes, and increased revenues from personal property tax audits. While the City will receive approximately $37.0 million from Wayne County in fiscal year 2003-2004 for delinquent 2003 property taxes, the City can expect to receive a lower amount in fiscal year 2004-2005. Any uncollected 2003 taxes will be netted against the 2004 delinquent tax advance, resulting in a reduced payment to the City. In addition, to date, the outside collection agency's efforts to collect delinquent property taxes have not yielded the anticipated results for the City. The 2004-2005 Mayor's Proposed Budget estimate of $79.6 million for the collection of delinquent taxes is optimistic.

Casino revenue is budgeted at $115.6 million in the 2004-2005 Mayor's Proposed Budget, or $5.6 million (5.1%) more than the $110.0 million included in the 2003-2004 Budget. The City's actual wagering tax revenue for 2002-2003 was $111.3 million, $6.3 million over the budget amount. For 2003-2004, the Budget Department estimates actual wagering tax revenue will be at $113.3 million, or $3.3 million (3.0%) more than the $110.0 million budget amount. Based on our reviews of actual and projected casino revenue data, the 2004-2005 budget of $115.6 million for casino wagering taxes appears reasonable.

Utility users tax revenue is estimated at $55.0 million in the 2004-2005 Mayor's Proposed Budget, the same amount that was budgeted in the 2003-2004 budget. The City's actual collections for the last five years for which data is available, have been within 5.0% of the budget estimates for utility users tax revenue. Based on the City's collection experience, we conclude that the $55.0 million estimate for utility users tax revenue for 2004-2005 is reasonable.

The 2004-2005 Mayor's Proposed Budget includes $886.7 million in revenues from bond sales. $675.0 million are Water and Sewerage Revenue Bonds, the remaining $211.7 million are Unlimited General Obligation and Limited General Obligation issues. Recurring bond sales for Capital Projects, totaling $42.0 million, and for New Vehicle Purchases, totaling $28.5 million, are included. In addition, the 2004-2005 Proposed Budget includes bond issues to cover current year expenditures - $61.1 million of self-insurance bonds to cover the risk management fund premium, and $80.1 million of pension obligation bonds to fund the current year amortization of the unfunded liability to the pension funds. Not included in the 2004-2005 Mayor's Proposed Budget are the $61.0 million of Fiscal Stabilization Bonds that will be sold to cover the fiscal year 2002-2003 deficit. While $80.1 million of pension obligation bonds are included in the 2004-2005 Proposed Budget, the City plans on funding the entire unfunded liability to the pension funds of $1.2 billion.

**Appropriations:**
The amount budgeted for salaries and wages has decreased by $12.1 million (1.4%) from $840.2 million in the 2003-2004 Budget to $828.1 million in the 2004-2005 Mayor's Proposed Budget. The 2004-2005 Mayor's Proposed Budget includes $20.0 million for the increase in salaries and wages due to pay rate increases of 5.0% for uniform employees, 2.0% for civilians, and pay range adjustments for certain underpaid job classifications. The salary and wage increases are contingent upon the continued ratification of various collective bargaining agreements currently under negotiation. The number of budgeted positions decreased 5.1%, from 19,702 positions to 18,705. The decrease is comprised of 377 layoffs, the net elimination of 263 budgeted positions (89 positions are added and 352 vacant positions are removed), and the separation of 357 Detroit Housing Commission employees from the City. Estimated employee turnover savings (which includes salaries and wages, most employer pension contributions, and other fringe benefits) is $24.8 million in the 2004-2005 Mayor's Proposed Budget, a decrease of $2.4 million from the $27.2 million budgeted for fiscal year 2003-2004.

Employee fringe benefits (including pensions) for the entire City increased by $79.7 million (or 15.4%) to $596.4 million in the 2004-2005 Mayor's Proposed Budget, as compared to $516.7 million in the 2003-2004 Budget. This $79.7 million increase is due mainly to a $52.5 million increase in pensions ($45.8 million for police and fire uniform employees and $6.7 million for civilian employees) and a $25.7 million increase in hospitalization costs for employees and retirees.

- The increase in employer pension contributions is primarily due to the decrease in the market value of the General Retirement System (GRS) and Policemen and Firemen Retirement System (PFRS) assets, poor returns for the past three years, and the low level of City contributions in prior years based on an over-funded status. The $224.1 million budgeted for pensions in the 2004-2005 Mayor's Proposed Budget is not sufficient to fund the City's projected required pension contributions. Using the contribution rates provided by the actuary for both the GRS and the PFRS, an additional $21.9 million or a total of $246.0 million will be necessary to fund the City's pension contributions in fiscal year 2004-2005. The 2004-2005 Mayor's Proposed Budget also includes $80.1 million in revenues related to the sale of Pension Obligation Bonds (POBs) to fund the City's required contributions for unfunded actuarial accrued liability (UAAL) for 2004-2005 to avoid massive layoffs of City employees and the reduction of City services.
- The hospitalization cost increase is mainly due to rising health care costs for retired City employees, which increased $29.1 million or 25.1% in the 2004-2005 Mayor's Proposed Budget.

**Current Year Projection:**
The 2004-2005 Mayor's Proposed Budget assumes no General Fund surplus or deficit for fiscal year 2004-2005, although the Budget Department currently projects a deficit of $0.3 million, which is subject to change. The estimates of General Fund revenue collections used to calculate the surplus/(deficit) appear reasonable.

**Other:**
Other items of financial importance and interest related to the 2004-2005 Mayor's Proposed Budget include the following:

1. Budget Stabilization Reserve Fund
   By the end of fiscal year 2003-2004, the Budget Stabilization Reserve Fund, the "Rainy Day Fund," will be reduced to $0.0, as the City will use the funds to cover the deficit incurred in fiscal year 2002-2003.

2. Risk Management Fund
   The City's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2003 included an estimate of Risk Management Fund type liabilities of $178.8 million. The current portion of this liability, payable within one year, is estimated at $8.4 million, while the long-term portion of the liability is estimated at $170.4 million. The average estimated liability, over the past nine years, is $188.9 million. Estimated Risk Management Fund liabilities remain high, which indicates that the City has not adequately identified and addressed the causes of damage, liability and worker's compensation claims against the City. Average annual payments made out of the Risk Management Fund for claims and judgments total $57.4 million.

3. Detroit Department of Transportation (DDOT)
   Total appropriations have declined by $3.1 million, due mostly to a $2.6 million reduction in the City's Subsidy to the People Mover that flows through the DDOT. Farebox revenues, budgeted at $29.1 million for fiscal year 2004-2005 are optimistic and rely on the proposed fare increase to disabled riders. Operating costs remain high at DDOT, even with the budgeted layoff of 112 employees. The General Fund contribution is budgeted to increase by $1.4 million, from $68.2 million budgeted in 2003-2004 to $69.6 million budgeted in 2004-2005

4. Funding Current Year Expenditures with Long-Term Debt
   The 2004-2005 Mayor's Proposed Budget includes $141.2 million in bond sales for 2004-2005 risk management and pension fund expenditures, both current expenditures. Issuing long-term debt for current year expenditures runs contrary to the purpose of the City's Debt Management Plan, which is "To issue debt only for capital purposes, and not to finance current operations or working capital."

5. Use of Pension Obligation Bonds (POBs)
   The 2004-2005 Mayor's Proposed Budget includes $80.1 million in revenues associated with the sale of POBs. The City plans to fund the entire $1.2 billion combined PFRS and GRS unfunded liability. While the use of POBs is expected to produce pension contribution savings to the City that are estimated at $24-$26 million per year, the Government Finance Officers Association (GFOA) has recommended that POBs be used with caution. POBs are attractive because of the potential earnings from risk arbitrage, the simultaneous purchase and sale of assets that are not equivalent. For the City's POBs to be successful, the pension funds would have to earn over 8% each year during the life of the bonds.

6. Detroit Transportation Corporation (People Mover)
   The Detroit Transportation Corporation (DTC) is primarily funded by grants from the City. The budgeted General Fund subsidy to the DTC is $7.7 million for 2004-2005, a decrease of $2.5 million from the 2003-2004 budget. Based upon the estimated ridership of 1,550,000, the cost of the budgeted subsidy is $4.99 for each ride. Although the $2.5 million reduction in the subsidy represents 18% of DTC's 2003-2004 expenditures of $14.0 million, the Mayor stated in his 2004-2005 Budget Message that the General Fund subsidy reduction would have no impact upon DTC's operations. This reduction may well have no impact upon DTC's operations in 2004-2005; however, the reduction may have negative effects in the long run.

7. Detroit Housing Commission (DHC)
   The 2004-2005 Mayor's Proposed Budget does not report the Detroit Housing Commission appropriations. In June 2003, the Michigan Supreme Court affirmed the decision of the Court of Appeals, thereby severing the employment relationship between the City and the DHC by operation of law. The separation from the City includes all aspects of the DHC including the capacity to hire, fire, transfer, and assign employees, as well as set job descriptions, compensated levels, and performance criteria.